



USDA Foreign Agricultural Service

GAIN Report

Global Agriculture Information Network

Template Version 2.09

Voluntary Report - public distribution

Date: 4/7/2004

GAIN Report Number: RS4020

Russian Federation

Solid Wood Products

Revision of the Russian Forestry Code

2004

Approved by:

Randall Hager
U.S. Embassy

Prepared by:

Mark Petry and Marina Muran

Report Highlights:

On March 18, 2004, the Russian government approved the draft of a new forest code that will soon be presented to the State Duma for hearings. Observers expect a heated debate over the new provision that allows private ownership of forests as a means to attract foreign investment. This provision and other changes were introduced in order to meet the goals of the government's forest development program for the period 2003-2010.

Includes PSD Changes: No
Includes Trade Matrix: No
Unscheduled Report
Moscow [RS1]
[RS]

Executive Summary.....	3
Building a New Forest Development Strategy	3
Revision of the Forest Code	4
Background.....	4
Main Provisions of the New Forest Code	4
Non-government organizations (NGOs) position on the new forest code.....	6
Hearings at the State Duma.....	6

Executive Summary

Russia's forest sector is of major national and global significance, accounting for over 60 percent of the country's total land. Russia is endowed with 25 percent of the world's forest resources, including half of all boreal coniferous forest and 22 percent of the world's standing timber. In addition, the sector is a major source of tax revenues, employment, and its forests provide the largest land-based carbon sink in the world.

However, Russia is not a major player in global forest trade industry. Although Russian exports of all forest products (Chapter 44 of the HTS) accounted for nearly four percent of all Russian exports in 2003, the country's share of the world's trade of forest industry products was just three percent, and it consisted mostly of raw and unprocessed forest products.

The introduction of a market economy in Russia exposed the weakness and artificial supports of central planned policies towards the forest sector. This led to unsustainable forest management practices and a collapse in forest output. It is estimated that the annual volume of round wood harvested dropped from 300 million cubic meters in 1990 to less than 100 million cubic meters by 2000.

Discussion of a new national forest policy to address the problems faced by the sector started in early 2001 when representatives of the federal government, industry, and science began to compile a new development strategy and policy framework (revision of the forest code). Unfortunately, a lack of transparency dominated these works and many interest groups were left out of the process.

Building a New Forest Development Strategy

Although the ruble devaluation in 1998 improved the competitiveness of the Russian forest industry, in 2004 it has become clear to Russian policy makers that the advantage of a favorable exchange rate is exhausted and new structural reforms are needed for the Russian forest sector to attract the interest of domestic and international investors.

Comparisons are often made with other countries when new forest strategies for Russia are pondered. Two models have been always taken into consideration by Russian policy-makers: Finland and Canada. Both of these national forestry models differ from the Russian tradition. In addition, these countries have a longer tradition of market driven policies for commercial forests, which is not the case in Russia.

A new set of principles was approved under the forestry development program for the period 2003-2010 (See GAIN report RS4007) to try to incorporate new mechanisms and policies to reach Russia's production potential. The main goals of the program are to double production of forest industry products by 2010, to increase the export share of high-quality/value-added forest products, and to make the forest sector profitable and self-financing by 2010.

These development strategies require long-term investments exceeding \$25 billion and a wide array of measures, including the reform of laws and rules, of which the forest code is a major component.

Revision of the Forest Code

Background

The State Duma adopted the current Russian forest code on January 22, 1997. It contains over 130 articles and represented the first comprehensive approach to bring rationality to the forest sector following the introduction of a market economy in Russia.

The 1997 forest code clarified the division of responsibilities between the different levels of government regarding forest management and revenue collection. In addition, it was first to address the role of the private operators in field-level forest management and timber extraction and introduced a competitive system for allocating timber rights. The most important concept of the 1997 forest code is the so-called the "Forest Fund" (also referred as "Forest Estate"), which is key to understanding the concept of forest management in Russia and different types of land use as established by Chapter 2 of the code.

However, several problems have arisen from the application of the 1997 forest code. One of these problems was decentralization in the decision-making process. Several forest management responsibilities were transferred from the federal government to regional levels without appropriate implementing rules, managers, and lack of funds to exercise their new acquired regulatory functions. This resulted in forest exploitation with economic and ecological losses to the country. Most of these problems were addressed during the annual International Forestry Forum held in St. Petersburg, on October 14-18, 2003 (See GAIN report RS3037).

Main Provisions of the New Forest Code

The Cabinet Ministers of the Russian Federation approved the new draft of the forest code on March 18, 2004. The draft will be presented to the State Duma for hearings and for final enactment soon. In addition to the new forest code, Russian legislators will have to tackle other regulatory procedures if the new code is to be effectively implemented.

The revision of the 1997 forest code is intended to encourage investment (both domestic and foreign), increase forest output and government revenues, and to enable a crackdown on illegal logging in order to form the basis for a sustainable forest management system.

The new version of the forest code addresses nearly all the basic principles of forestry, including long-term sustainability of the sector, ownership, pricing, leasing and administration of forests. In addition, the new forest code is expected to create the framework to improve the numerous problems of the sector such as poor infrastructure (lack of appropriate transportation models, undeveloped processing facilities, and lack of modern technology for harvesting), lack of investment, administrative problems with different levels of management, corruption, illegal logging, and exploitation of natural resources without long-term sustainability.

There are basically three major provisions in the new version that have triggered reaction from both legislators and interest groups (environmentalists, NGOs, industry): 1) private ownership of forests; 2) distribution of forest plots through auctions; and 3) management of forest resources by the federal government.

1. Private ownership of forests

The main novelty of the new draft of the forest code is the introduction of private ownership of the forest estate after the user demonstrates successful management of the forest, initially facilitated through a long-term lease. However, state ownership of the forests will remain the main pattern of ownership. Under the new forest code, private operators will get harvesting rights through long-term leases or concessions if they abide by a broad range of economic, legal, and environment criteria established by the code. Foresters are expected to observe the terms of the lease for a minimum of 15 years, after which they will be allowed to buy their plots at a price equal to ten-fold the annual lease fee. Foreign investors will be allowed to make purchases, except for plots along Russia's national borders.

According to Deputy Minister of Economic Trade and Development (MEDT) Tsikanov, direct government revenues from the leasing of forest assets will rise sharply as a result of the new code and are estimated to reach \$63 million per year.

One of the controversial clauses in the new code is an unclear rule that relates to public access to privately owned forests. Interest groups want to guarantee the right to each Russian citizen to have free access to woodlands for recreation or gathering of berries and mushrooms (considered more than a pas time in Russia) as part of a cultural inheritance.

2. Distribution of forest plots through auctions

There is also a strong debate among legislators about a transparent market-based mechanism regarding auctions for standing timber strictly based on financial conditions (best price offered) and not other technical and social criteria, such as the benefits from road construction and job creation.

There are also some concerns about the selection process involved in the auctions, such as what role the federal government and each local administration will play. According to Chairman of Natural Resources Committee at the State Duma Natalya Komarova, the authors of the new forest code draft did not want to differentiate among categories of market actors, preferring to equate non-federal government entities with private companies and individuals.

3. Management of the forest resources

Since the enactment of the 1997 forest code, the federal government has lost considerable authority to regional and local officials. There are 81 regional officers who oversee 1,740 local (or district) forest management units, called leskhozoes.

In Russian history, forest management has always been under federal control. Due to central government budgetary shortfalls, the amount of funds available for forestry has declined substantially, making the forest management system increasingly dependent on income generated from non-forest activities. Regional and local (or district) authorities are dependant on income from forestry charges, company fees, and fines. Inadequate funding of local forest services (leskhozoes) leads to deficient law-enforcement, which results in more illegal logging. Mismanagement of forest resources also results in excessive cuttings.

Among the main provisions of the new draft code is the reduced authority of regional administration in the decision-making process. It is estimated that the new draft code will provide 95 percent of the control to the federal government and only five percent to the regions. The new forest code will also need to clarify the breakdown of forestry charges (transparent system for pricing forest auctions) between the levels of government. A key issue in this area is minimum stumpage revenue.

Non-government organizations (NGOs) position on the new forest code

Non-government organizations in Russia, including Greenpeace, World Wildlife Fund, Wild Nature Conservation Center, and other NGOs have expressed their anxiety with the lack of transparency in the drafting process of the new forest code. They also criticized the extremely short period of time involved in the preparation of the new code, which is not sufficient to address the wide array of themes, problems, and interests of the Russian forest sector.

Representatives of the environmental non-government organizations in Russia met on March 25, 2004 with a group of officials from the Ministry of Economic Development and Trade (MEDT) to voice their positions and concerns against the new forest code. According to the release provided by the NGOs, before the new forest code is submitted to the State Duma, the Russian government should consider the following points:

- a) Forests are not just state property that need an effective owner, but a natural resource of not only economic, but also life supporting ecological importance as the "basis for people's life and activity" (Article 9 of the Constitution of the Russian Federation);
- b) Large-scale privatization of forestlands is dangerous for the future of Russia as privatization of some forest categories will weaken their protection and environmental functions. The government should not create conflict between private owners and public interests. Protection of forests should remain a state function. The government should not make legal provisions that will enable private leasers or owners to restrict the presence of citizens to the forests. All loopholes for such restrictions should be eliminated from the new code;
- c) Restrictions on people's access to forests should only be imposed by responsible authorities or by the courts – in cases specified by law;
- d) The introduction of the new forest code should not create the opportunity to destroy regional and local special protected nature areas (SPNA) or to prevent new SPNAs from being created. The code should provide the possibility to create new special protected nature areas in forestlands;
- e) The new forest code should not weaken the existing restrictions on forest use in the protection of forests, which could result in their logging, carried out as maintenance logging and intermediate logging. The paragraphs that will enable weakening of such restrictions should be removed from the new forest code;
- f) The new forest code should not result in the elimination of the existing system of leskhozoes. Their functions regarding forest management should be clearly defined in the new forest code.

No mutual understanding on the issue of forest privatization was achieved with government officials, although MEDT officials agreed to review some points raised by the NGOs, including free access to forests by Russian citizens. Moreover, according to Chairman of Natural Resources Committee at the State Duma, opinions of business and environmentalists and academics are being heard. The Natural Resources Committee has an expert committee of several dozen academics and businessmen to advise on natural resource policy.

Hearings at the State Duma

The final text of the forest code will reach the State Duma soon and observers expect a heated debate on the new provision regarding private ownership of forests. This provision has numerous proponents, as well as opponents. Russian President Vladimir Putin spoke about the importance of the Forest Code at his meeting in the Kremlin with Minister of

Natural Resources Trutnev. The president emphasized that any decision on this matter "should be well-grounded and made after a plentiful discussion with the scientific and public communities."

Reform of the current forest code is key to improving forest protection in Russia due to the increasing illegal logging, especially in northwest Russia (estimated at nearly 30 percent of the total harvest) and in the Russia Far East (estimated at nearly 50 percent).

The debate over private ownership of forests in Russia and its final provision to be enacted by State Duma will also set the path to attract future foreign investments and will outline the terms of that investment.